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FORM 10-Q
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

MAY 1 1 1992

Quarterly Report Under Section 13 or 15 (d) of the Securities Exchange Act of 1934

For Quarterly Period Ended March 31, 1992

SEC 2234

Commission File # 2-76555

SDN BANCORP

(Exact name of registrant as specified in its charter)

California (State or other jurisdiction of incorporation or organization)	95-3683748 (I.R.S. Employer Identification No.)
135 Saxony Road, Encinitas, California (Address of principal executive offices)	92024-0905 (Zip Code)

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Registrant's telephone number, including area code 619-436-6888

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X No ____

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Stock, no par value Class	564,145 Outstanding on March 31, 1992

SDN BANCORP AND SUBSIDIARY
SECURITIES AND EXCHANGE COMMISSION FORM 10-Q
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SDN BANCORP AND SUBSIDIARY

Condensed Consolidated Statements of Condition
March 31, 1992 and December 31, 1991
(Dollars in thousands)

	March 31, 1992 (Unaudited)	December 31, 1991
Assets		
Cash and due from banks	$ 8,637	$ 8,034
Interest bearing deposits with financial institutions	1,470	1,765
Investment securities	3,838	3,891
Federal funds sold	3,500	4,600
Loans	67,687	71,601
Less allowance for loan losses	740	1,128
Loans, net	66,947	70,473
Premises and equipment, net	1,139	1,158
Other real estate owned	263	-
Accrued interest receivable and other assets	2,086	1,828
	$ 87,880	$ 91,749
Liabilities and Shareholders' Equity		
Deposits:		
Demand:		
Non-interest bearing	$ 19,372	$ 22,008
Interest bearing	10,838	9,275
Savings:		
Regular	4,041	3,648
Money market	21,479	22,002
Time:		
Under $100,000	9,634	11,251
$100,000 or more	17,923	18,996
Total deposits	83,287	87,180
Accrued expenses and other liabilities	332	356
Notes payable	746	746
Long-term debt	1,219	1,219
Total liabilities	85,584	89,501
Shareholders' Equity:		
Contributed capital	2,951	2,951
Retained earnings (deficit)	(655)	(703)
Total Shareholders' Equity	2,296	2,248
	$ 87,880	$ 91,749

See accompanying notes to condensed consolidated financial statements.

SDN BANCORP AND SUBSIDIARY
Condensed Consolidated Statements of Operations
Three months ended March 31, 1992 and 1991
(Dollars in thousands, except for per share amounts)
(Unaudited)

	1992	1991
Interest Income:		
Interest and fees on loans	$ 1,745	$ 1,933
Interest on Federal funds sold	20	71
Interest on deposits with financial institutions	28	27
Interest and dividends on investment securities	69	58
Total interest income	1,862	2,089
Interest Expense:		
Deposits	751	1,059
Other borrowed funds	45	56
Total interest expense	796	1,115
Net interest income	1,066	974
Provision for loan losses	25	45
Net interest income after provision for loan losses	1,041	929
Other operating income	163	103
Other operating expense	1,151	1,140
Earnings (loss) before income taxes	53	(108)
Provision (benefit) for income taxes	5	(43)
Net earnings (loss)	$ 48	$ (65)
Earning (loss) per share:		
Primary	$ .08	(0.11)
Assuming full dilution	$ .08	(0.11)

See accompanying notes to condensed consolidated financial statements.

SDN BANCORP AND SUBSIDIARY

Condensed Consolidated Statements of Cash Flows
For the Three Months Ended March 31, 1992 and 1991
(Dollars in thousands)
(Unaudited)

	1992	1991
Operating Activities:		
Net earnings (loss)	$ 48	$ (65)
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	25	45
Depreciation and amortization	71	62
Increase in accrued interest receivable	(40)	(27)
Decrease in accrued interest payable	(13)	(14)
Other - net	(492)	(459)
Net cash used by operating activity	(401)	(458)
Investing Activities:		
Net decrease in interest bearing deposits in other financial institutions	295	86
Proceeds from sales and maturities of investment securities	53	9
Net decrease(increase) in loans	3,501	(3,310)
Purchases of premises and equipment	(52)	(73)
Net cash provided(used) by investing activities	3,797	(3,288)
Financing Activities:		
Net increase(decrease) in deposits	(3,893)	2,282
Proceeds from issuance of common stock	-	24
Net cash provided (used) by financing activities	(3,893)	2,306
Net decrease in cash and cash equivalents	(497)	(1,440)
Cash and cash equivalents at January 1, 1992 and 1991	12,634	12,395
Cash and cash equivalents at March 31, 1992 and 1991	$ 12,137	$ 10,955

See accompanying notes to condensed consolidated financial statements.

SDN BANCORP AND SUBSIDIARY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

March 31, 1992

(Unaudited)

NOTE 1:

The condensed consolidated financial statements include the accounts of SDN Bancorp ("Bancorp"), a Bank holding company, and its wholly-owned subsidiary, San Dieguito National Bank ("Bank").

In the opinion of management, the accompanying unaudited interim condensed consolidated financial statements contain all adjustments, consisting of only normal recurring accruals, necessary to present fairly the financial position as of March 31, 1992 and the results of operations and statements of cash flows for the three months ended March 31, 1992 and 1991.

While management believes that the disclosures presented are adequate to make the information not misleading, it is recommended that these financial statements be read in conjunction with the financial statements and the notes included in Bancorp's 1991 annual report.

NOTE 2:

Primary earnings per share data is computed by dividing net income by the weighted average number of shares of common stock and common stock equivalents outstanding. Stock options, which are common stock equivalents, have been included in the calculation of primary earnings per share. The assumed conversion of the Mandatory Convertible Debentures ("Debentures"), which are not common stock equivalents, were antidilutive as of March 31, 1992. The weighted average number

of shares used to compute the primary earnings (loss) per share was 587,305 for the three months ending March 31, 1992 and 601,804 for the three months ending March 31, 1991. The weighted average number of shares used to compute earnings (loss) per share assuming full dilution was 587,305 for the three months ending March 31, 1992 and 601,804 for the three months ending March 31, 1991.

NOTE 3:

Beginning January 1, 1993, Bancorp will be required to apply the provision of Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" which amended and allowed a one-year deferral of the effective date of Statement of Financial Accounting Standards No. 96. Although Bancorp has not completed a full assessment of the effects of adoption of such statement, no material adverse consequences are anticipated.

NOTE 4:

Bancorp has a $210,000 Promissory Note and a $150,000 Optional Advance Note payable to another bank. The Optional Advance Note is drawn on as necessary to meet Bancorp's debt service requirements. The balance outstanding on the Optional Advance Note was $111,000 as of March 31, 1992. Both of these notes bear interest at prime rate plus 2.0% and are due July 31, 1992. Both notes are secured by all the outstanding shares of common stock of the Bank.

On October 15, 1991, Bancorp executed a $75,000 Promissory Note payable to a Director of Bancorp and Bank. The proceeds of this note was used to pay net interest expense of the mandatory convertible debentures. This note bears interest at prime rate plus 2.0% and is due October 15, 1992.

During the first quarter of 1992, Bancorp executed promissory notes to directors aggregating $200,000 and promissory notes to shareholders aggregating $150,000. The proceeds of these notes were used to pay down a promissory note from another bank. These notes bear interest at prime plus 2.0% and are due during the first quarter of 1993.

Item 2.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS FOR SDN BANCORP

Three months

March 31, 1992

SUMMARY:

SDN Bancorp ("Bancorp") owns 100% of San Dieguito National Bank ("Bank"). Bancorp has had no significant business activities independent from the Bank. Accordingly, the following discussion relates primarily to the operating results and financial condition of the Bank.

Average earning assets of the Bank for the first three months of 1992 were approximately $78.3 million, representing an increase of $6.2 million or 8.6% from the average for the comparable three-month period in 1991. Total assets at March 31, 1992, were $87.9 million compared to total assets of $91.7 million at December 31, 1991 and $82.4 million at March 31, 1991.

Average loans for the first three months of 1992 were approximately $70.5 million, representing an increase of $7.6 million or 12.1% from the average of $62.9 million for the first three months of 1991. This increase in average loans is largely due to a $5.3 million increase in average commercial loans and a $2.4 million increase in average consumer and equity loans.

Total loans at March 31, 1992 were $67.7 million compared to $71.6 million at December 31, 1991. Construction and real estate loans decreased $3.1 million from December 31, 1991 to March 31, 1992 because of conservative lending practices and a slowdown in the real estate market.

Total deposits decreased to $83.3 million at March 31, 1992 compared to $87.2 million at

December 31, 1991. This decrease in total deposits is primarily due to a $2.7 million reduction in higher costing certificates of deposit that were allowed to run off.

For the three months ended March 31, 1992, Bancorp realized net earnings of $48,000 compared to a net loss of $65,000 for the same period in 1991. The 1992 increase in net earnings is primarily due to a $92,000 increase in net interest income (see additional comments below under Net Interest income and Net Interest Margin) and a $60,000 increase in other operating (non-interest) income in 1992 compared to the same period in 1991.

Net Interest Income and Net Interest Margin

In the first three months of 1992, Bancorp's net interest income (including loan fees) increased by $92,000 or 9.4% compared to the same period in 1991. This increase is principally the result of a greater decrease in costs of funds than the decrease in total interest income for the first three months of 1992 compared to the same three-month period in 1991. Even though average loan balances were higher in 1992 compared to the first quarter of 1991, the decrease in interest rates in the first quarter of 1992 compared to 1991 resulted in a decrease in interest income and fees on loans.

Comparing the first three months of 1992 to that of 1991, the yield on average earning assets decreased to 9.6% from 11.8%, while the average cost of interest bearing liabilities decreased to 4.8% from 7.2%. The net interest margin was 5.5% for both the first three months of 1992 and 1991.

Loan fee income was approximately the same for the first three months of 1992 compared to that of 1991. Loans on non-accrual status were approximately $1,200,000 more at March 31, 1992

compared to March 31, 1991. (See additional comments below under Allowance and Provision for Loan Losses.)

In January 1991, the Bank introduced a new tiered money market account which pays higher interest rates on average balances of $10,000 or greater. The $8.7 million increase in money market balances at March 31, 1992 compared to March 31, 1991 is a direct result of the success of this new account. At this time of declining interest rates, depositors are increasingly placing more of their funds into higher interest money market accounts or are taking their funds out of banks to invest in mutual funds or insurance products. This accounts for the majority of the reduction in the Bank's time deposits under $100,000.

The Bank's funding sources from non-interest bearing deposits increased during the first three months of 1992 compared to the first three months of 1992. This increase was a result of additional deposits from the new office in Carlsbad and an increase in average deposits from two escrow companies.

Allowance and Provision for Loan Losses

The allowance for loan losses represents the remainder of amounts which have been set aside for the specific purpose of absorbing losses which may occur in the Bank's loan portfolio. The provision for loan losses is an expense charged against operating income and added to the allowance for loan losses. Management of the Bank continues to carefully monitor the allowance for loan losses in relation to the size of the Bank's loan portfolio and known risks or problem loans.

The allowance for loan losses was $1,128,000 at December 31, 1991 and has decreased to $746,000 at March 31, 1992 primarily as a result of the March, 1992 charge-off of two loans totaling $375,000 which were fully reserved at December 31, 1991. The provision for possible loan losses was $25,000, loan charge-offs were $415,000 and recoveries were $2,000 during the first three months of 1992. The balance of the allowance for loan losses was 1.1% of gross loans at both March 31, 1992 and March 31, 1991.

Non-performing loans increased to $2,762,000 or 4.1% of outstanding loans at March 31, 1992 compared to $2,495,000 or 3.5% at December 31, 1991. The March 31, 1992 figure includes $2,274,000 in loans on non-accrual status compared to $2,470,000 at December 31, 1991 and $1,068,000 at March 31, 1991. At March 31, 1992, there was $448,000 in other loans past due ninety days or more and still accruing interest compared to $25,000 at December 31, 1991. These other loans of $448,000 consist of two first trust deed loans secured by residential real estate. At March 31, 1992, the Bank had "Other Real Estate Owned" in the amount of $263,000 as a result of a January, 1992 foreclosure.

A portion of the non-performing loans represents the Bank's willingness to allow loans to go into default in order to pursue collection efforts rather than to grant liberal loan renewals. Most of the non-performing loans are secured by residential real estate. Given the current recession, economic conditions and the Bank's real estate and construction loan portfolio, it is likely the level of non-performing loans will increase until conditions improve.

The allowance for loan losses reflects management's ongoing evaluation of the risks inherent

in the loan portfolio both generally and with respect to specific loans, the present state of the economy, the level of net loan losses experienced in the past, as well as the careful ongoing evaluation of the loan portfolio of the Bank by management. Although no assurance can ever be given that actual losses will not exceed the amounts provided for in the allowance, management believes that the allowance for loan losses is adequate in light of all known relevant factors. However, increased costs of collection on some of these loans, non-accrual of interest on those of which are or may be placed on non-accrual, and the possibility of further charge-offs could have an adverse impact on Bank's and Bancorp's profitability in the future.

Other Operating Income

Other operating (non-interest) income increased by $60,000 for the first three months of 1992 compared to the same period in 1991. The first three months of 1992 include a $30,000 gain recognized on a sale of other real estate owned. In addition, deposit service charge income increased $25,000 during the first three months of 1992 compared to the same three-month period in 1991.

Other Operating Expenses

Other operating (non-interest) expenses for the first three months of 1992 increased $11,000 compared to the first three months of 1991. This is a result of an $11,000 increase in the FDIC regulatory assessments, a $16,000 increase in general insurance and legal costs offset by a $16,000 decrease in business development expense during the first three months of 1992 compared to the same three-month period in 1991.

Management recognizes the need to reduce its overhead ratio if the Bank and Bancorp are to

achieve consistent, acceptable levels of profitability. Nonetheless, since many of the Bank's costs are fixed, their impact on the overhead ratio cannot be substantially improved without a significant increase in the Bank's size.

Provision for Income Taxes

The income tax expense for the first three months of 1992 is computed using the statutory, Federal and State tax rates reduced by net operating loss carryforward from 1991.

Capital Resources

Current risk-based capital standards generally require banks and holding companies (except for non-diversified holding companies with less than $150 million in assets) to maintain a ratio of "core" or "tier 1" capital (consisting principally of common equity) to risk adjusted assets of at least 4%, and a ratio of total capital (which includes core capital and certain forms of subordinated debt, reserves for loan losses, and preferred stock) of at least 7.25% to risk adjusted assets (8.0% beginning on December 31, 1992). Risk adjusted assets are calculated by multiplying the balance in each category of assets according to a risk factor which ranges from zero for cash assets and certain government obligations to 100% for some types of loans, and adding the products together. As of March 31, 1992, the Bank's risk-based capital ratio was 7.4%, compared to the current 7.25% minimum, and the Bank's core capital ratio was 5.5%, compared to the 4.0% minimum standards.

While management believes that the Bank's and Bancorp's capital positions are sufficient for the current level of assets, the Bank will need to increase capital to provide the base for growth and to meet December 31, 1992 capital ratio requirements. In addition, management is actively seeking

additional capital or debt funds to pay debt service on its Debentures, as well as the debt service and refinancing of short-term notes payable. There is no assurance that such new sources of capital or debt will be obtained in light of the current economic environment.

New leverage capital standards became effective in April, 1991, which requirements were established to ensure that a portion of a bank's existing assets and future asset growth will be funded by shareholders' equity and not by insured deposits alone. The Bank is in conformity with these new standards which include a 3.0% minimum leverage ratio. It is anticipated that emerging guidelines will require banks to increase their capital base.

Liquidity

The Bank relies primarily on deposits as its principal source of funds and, therefore, must be in a position to service depositors' needs as they arise. Management of the Bank attempts to maintain loan-to-deposit ratio of approximately eighty-five percent and a liquidity ratio (liquid investments to deposits and other short term liabilities) of not less than twenty percent. The average loan-to-deposit ratio was 87% for the three-month period ending March 31, 1992, and was 87% for the same period in 1991. Average liquidity was 16% during the first three months of 1992 and 18% during the same period in 1991. While fluctuations in escrow and title company deposits cause temporary increases and decreases in liquidity from time to time, the Bank has had no significant trouble dealing with such fluctuations from existing liquidity sources and solicitation of other deposits.

Should the level of liquid assets (primary liquidity) not meet the liquidity needs of the Bank, other available sources of liquidity (secondary liquidity) include purchase of federal funds, sale of

repurchase agreements, sale of loans, and the discount window facilities of the Federal Reserve Bank. The Bank has rarely used these sources in the past since its liquidity levels have been maintained primarily through funds provided by deposits. The Bank has identified loans which could be sold if necessary.

Bancorp's liquidity needs are primarily limited to regulatory compliance costs and debt service. To partially offset the interest payments on Bancorp's $1,219,000 of Debentures, Bancorp receives interest payments from the Bank's $550,000 of Debentures totaling approximately 45% of Bancorp's Debenture interest expense. In order for Bancorp to meet its debt service requirements, it was necessary to obtain loans as set forth in Note 4 to the condensed consolidated financial statements, and it will be necessary to obtain additional equity or debt financing in the future.

There are legal limitations restricting the extent to which the Bank can lend or dividend funds to Bancorp. At March 31, 1992, it appears that the Bank could not declare dividends without the approval of the Comptroller of the Currency. Bank policy currently in effect precludes the payment of cash dividends.

Economic Considerations

Approximately 85% of the Bank's loan portfolio at March 31, 1992 is in short-term loans tied to a floating rate which changes annually or more frequently (64% is tied to a daily floating prime rate). This enables the Bank to adjust its yields quickly in a changing interest rate environment. The Bank remains more sensitive to interest rate changes on the asset side than on the liability side throughout all time horizons. This is partly because the volume of non-interest bearing funding

sources (demand deposits and capital) exceeds the volume of non-interest earning assets. Given the composition of the Bank's balance sheet at March 31, 1992, declining market rates of interest will generally have a negative impact on the Bank's net interest income, while rising interest rates will have a positive effect, absent other factors.

The majority of Bancorp's assets and liabilities are monetary items held by Bank, the value of which (in dollars) is not affected by inflation; only a small portion of total assets is in premises and equipment. Although the inflation rate has been much lower in recent years, its effect on the Bank did not have the positive impact that may have been felt by other industries. The small fixed asset investment of the Bank minimizes any material misstatement of asset values and depreciation expenses which may result from fluctuating market values due to inflation. Inflation may, however, increase other operating expenses or have adverse effects on the Bank's customers. Rates of interest paid or charged in the marketplace generally rise in relation to current or anticipated inflation.

Other

The Financial Institutions Reform, Recovery and Enforcement Act of 1989 was signed into law August 8, 1989. The Federal Deposit Insurance Corporation Improvement Act of 1991 was signed into law on December 19, 1991. In addition to providing for the recapitalization of the Bank Insurance Fund, this new 1991 law makes a number of changes in the legal environment for insured banks, including reductions in insurance coverage for certain kinds of deposits, increases in consumer-oriented requirements, and major revisions in the process of supervision and examination of depository institutions.

In addition, Federal officials have stated they plan to make other changes to existing bank laws and regulations, which may impact a bank's ability to extend branch operations across state lines, own insurance and security affiliates, and permission for non-financial institutions to own and operate banks.

While it is currently impossible to ascertain the impact of new laws as well as possible changes to bank laws and regulations, it is expected they would increase bank operation expenses and competition. It is also not possible to fully ascertain the impact of recent mergers of large in-state banks as well as competition from out-of-state banks that can purchase thrift institutions without geographical limitations.

PART II

ITEM 4. Submission of Matters to a Vote of Security Holders

On April 17, 1992, Bancorp held its annual meeting of shareholders at which the following item was voted and approved:

1. The following directors were re-elected:

Leonard R. Cory	Donald A. Klatt
J. Peter Fitzpatrick, D.D.S.	Thomas T. Minamide
Robert E. Grice	James E. O'Neal
William F. Howell	Paul E. Schedler
M. Tamie Kimura	Robert O. Weston

ITEM 6. Exhibits and Reports on Form 8-K

(a) Exhibits: None

(b) Reports on Form 8-K: None

SDN BANCORP AND SUBSIDIARY

SECURITIES AND EXCHANGE COMMISSION FORM 10-Q

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SDN BANCORP

DATE: 5-12-92 Paul E. Scheller
Paul E. Scheller
President

DATE: 5/12/92 Cathy J. Wingenbach
Cathy J. Wingenbach
Principal Accounting Officer